

**DEPARTMENT OF TAXATION  
STATE OF HAWAII**

Audit of Expenditures  
For the Quarter Ended September 30, 2004

Internal Audit Report No. 05-28

**AUDIT DIVISION**  
Department of  
Accounting and General Services  
July 22, 2005



## EXECUTIVE SUMMARY

The Department of Accounting and General Services, Audit Division conducted an audit of the Department of Taxation's (the Department) expenditures for the quarter ended September 30, 2004 to determine whether expenditure payments made by the Department are legal, recorded to the proper account, in compliance with applicable laws, rules and regulations, policies and procedures, and established accounting procedures and internal controls.

The mission of the Department is to administer the tax laws for the State of Hawaii in a consistent, uniform and fair manner.

With respect to the audit of the Department's expenditures, we noted the following:

- An expenditure of \$1,252.64 procured through the small purchases process was not in compliance with Section 103D-305, Hawaii Revised Statutes (HRS) and Procurement Circular 2003-01, Amendment 1, which require a minimum of three quotes and the completion and retention of State Procurement Office Form-10.
- Five (5) contracts procured through the competitive sealed bid and proposal process were not in compliance with Sections 3-122-33(e) and 3-122-57(a), Hawaii Administrative Rules, HAR, which requires posting of award for 5 working days.

We recommend the Department establish controls to comply with Section 103D-305, HRS, Procurement Circular 2003-01, Amendment 1, and Section 3-122-33(e) and 3-122-57(a), HAR.

In response, the Department concurs with the audit findings and will take corrective actions to comply with Section 103D-305, HRS, Procurement Circular 2003-01, Amendment 1, and Sections 3-122-33(e) and 3-122-57(a), HAR.

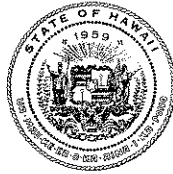
**DEPARTMENT OF TAXATION  
STATE OF HAWAII**

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## I. INTRODUCTORY SECTION

LINDA LINGLE  
GOVERNOR



Russ K. Saito  
Comptroller

Katherine H. Thomason  
Deputy Comptroller

**STATE OF HAWAII**  
**DEPARTMENT OF ACCOUNTING**  
**AND GENERAL SERVICES**

P.O. BOX 119  
HONOLULU, HAWAII 96810-0119

AUD 06.0004

July 22, 2005

The Honorable Kurt Kawafuchi  
Director  
Department of Taxation  
State of Hawaii  
Princess Ruth Keelikolani Building  
830 Punchbowl Street  
Honolulu, Hawaii 96813

Dear Mr. Kawafuchi:

In accordance with the provisions of Section 26-6 of the Hawaii Revised Statutes, I present you with a financial audit report on the Department of Taxation's expenditures for the quarter ended September 30, 2004.

The report is presented in two sections: introductory and noncompliance. The introductory section includes this transmittal letter, a summary of services, introduction, background, scope, objectives, methodology, and audit procedures performed. The noncompliance section includes a schedule of audit findings with recommendations.

Sincerely,

A handwritten signature in black ink, appearing to read "Russ K. Saito".

RUSS K. SAITO  
State Comptroller

## **SUMMARY**

The Department of Accounting and General Services (DAGS), Audit Division, conducted an audit of the Department of Taxation's (the Department) expenditures for the quarter ended September 30, 2004 to determine whether expenditure payments made by the Department are legal, recorded to the proper account, in compliance with applicable laws, rules and regulations, policies and procedures, and established accounting procedures and internal controls.

## **INTRODUCTION**

Authority to conduct this audit resides in Section 26-6, Hawaii Revised Statutes (HRS), which authorizes after-the-fact audits to determine the legality of expenditures and the accuracy of the accounts. In addition, Section 40-2, HRS, requires the State Comptroller to ensure that all accounting procedures and internal controls of departments in the executive branch of the State government adhere to prescribed policies and procedures and accounting principles generally accepted in the United States of America.

This audit is part of the Audit Division's 2004-2005 Audit Plan. The Audit Division maintains its organizational independence in accordance with Section 3.27, Independence Standards, *Government Auditing Standards*.

Audit fieldwork took place January 28, 2005 through March 31, 2005 at the DAGS' Pre-Audit Branch and the Department's fiscal office at 830 Punchbowl Street, Honolulu, Hawaii. Rod B. Catigay, CPA, Supervising Auditor, conducted the audit, under the supervision of Wayne L. Chu, CPA, Audit Division Administrator.

## **BACKGROUND**

The Department was created in 1959 by the Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959). The primary function of the Department is to administer and enforce the tax revenue laws of the State and collect all taxes and other payments payable thereunder.

## **SCOPE, OBJECTIVES, AND METHODOLOGY**

The audit includes an examination of expenditures paid by the Department during the period July 1, 2004 through September 30, 2004. The audit objectives are to determine the legality of expenditures, accuracy of accounts, and the Department's compliance with applicable laws, rules and regulations, policies and procedures, and established accounting procedures and internal controls.

Department of Taxation  
Audit of Expenditures Report – Quarter Ended September 30, 2004

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This report includes detail testing of a sample of expenditure transactions and does not include the Department's other financial transactions, such as payroll expenditures, cash receipts, journal vouchers (JVs), and payments to other governmental agencies. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

A listing of the Department's expenditures for the quarter ended September 30, 2004, from the State's Financial Accounting and Management Information System, was used for sampling and verification to source documents during the audit. The Department processed for payment 6,887 expenditure transactions totaling \$1,115,942,107.10 during the quarter ended September 30, 2004.

We examined 115 randomly selected expenditure transactions, totaling \$6,808,975.20, as outlined below:

	Total Population	Sample	
		Count	Amount
Expenditures	\$ 57,102,440.65	110	\$ 6,676,621.42
Contract expenditures:			
Competitive bids	132,810.97	4	42,222.13
Competitive proposals	90,131.65	1	90,131.65
Payroll expenditures and JVs	1,034,075,808.38	-	-
Payments to other governmental agencies	<u>24,540,915.45</u>	<u>-</u>	<u>-</u>
Totals	<u>\$1,115,942,107.10</u>	<u>115</u>	<u>\$ 6,808,975.20</u>

To gain an understanding of the Department's procedures in processing expenditures for payment and documenting the internal control system related to those procedures, we interviewed appropriate personnel, reviewed applicable available written policies and procedures, and documented our understanding of the established accounting procedures and internal controls in place during the audit period.

#### AUDIT PROCEDURES PERFORMED

We reviewed documents supporting expenditures such as vendor's invoices, purchase orders, summary warrant vouchers, requisition forms, procurement documents, contracts and inventory records to determine compliance with applicable laws, rules and regulations, policies and procedures, and established accounting procedures and internal controls.



Department of Taxation

Audit of Expenditures Report – Quarter Ended September 30, 2004

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Based on our detail testing of expenditure transactions, we found 110 expenditures and 5 contract expenditures to be legal expenditures of the Department, properly recorded and processed by the Department, and in compliance with applicable laws, rules and regulations, policies and procedures, and established accounting procedures and internal controls, except for the 2 audit findings presented in the noncompliance section of the report.

## II. NONCOMPLIANCE SECTION

## **AUDIT FINDINGS WITH RECOMMENDATIONS**

The procedures enumerated below were performed to determine whether payments made by the Department are legal, recorded to the proper account, in compliance with applicable laws, rules and regulations, policies and procedures, and established accounting procedures and internal controls.

### **AUDIT FINDING NO. 1 – SMALL PURCHASES – MINIMUM OF THREE QUOTES**

Section 103D-305, HRS, states that procurements of less than \$25,000 for goods, services, or construction shall be made in accordance with procedures set forth in rules adopted by the policy board that are designed to ensure administrative simplicity and as much competition as is practicable. Section 3-122-75, HAR, Procurement Directive No. 2002-4, and Procurement Circular 2003-01, Amendment 1, state that a minimum of three quotes are required for the procurement of goods and services of \$1,000 or more but less than \$15,000. Also, the Department's completion of the State Procurement Office (SPO) Form-10 is mandatory. Further, Section 3-122-77, HAR, requires that all quotations received shall be recorded and placed in a procurement file.

We noted that an expenditure for the procurement of goods in the amount of \$1,252.64 was not in compliance with Procurement Circular 2003-01, Amendment 1. The Department did not have written evidence of three quotes and the SPO Form-10 was not filed in the Department's procurement files.

#### **Procedures Performed**

We interviewed the Department's staff that participated in the procurement of goods and services and we examined the available expenditure and procurement files.

We found no written evidence of the Department obtaining three quotes or completing SPO Form-10 for the expenditure noted above in the procurement files.

#### **Recommendation**

The Department shall establish a control to comply with Section 103D-305, HRS, and the related rules and regulations established and stated in Section 3-122-75, HAR, Procurement Directive No. 2002-4, Procurement Circular 2003-01, Amendment 1, and Section 3-22-177, HAR. The Department shall obtain three quotes and complete SPO Form-10 showing complete compliance with Section 103D-305, HRS, and the related rules and regulations established and shall place the form in the procurement files.

**AUDIT FINDING NO. 2 – COMPETITIVE SEALED BID AND PROPOSAL – POSTING OF AWARD**

Sections 3-122-33(e) and 3-122-57(a), HAR, state that the award shall be issued to the lowest responsive bidder whose bid meets the requirements and criteria set forth in the invitation for bids and posted pursuant to Section 103D-701, HRS, for 5 working days.

We noted four contracts procured through the competitive sealed bid process and one contract procured through the competitive sealed proposal process for the procurement of services that were not in compliance with Sections 3-122-33(e) and 3-122-57(a), HAR, regarding the posting of the award requirement. In lieu of posting the award, the Department sent non-selection letters or called the unsuccessful bidders. SPO interprets the posting of award requirement as a physical posting of a notice of award.

**Procedures Performed**

We interviewed the Department's staff that participated or who were familiar with the procurement of the five contracts and examined the contract project files.

We did not find written evidence in the contract project files that the awards were posted for 5 working days.

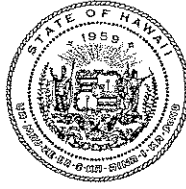
**Recommendation**

The Department shall establish a control to comply with Sections 3-122-33(e) and 3-122-57(a), HAR. A copy of the document showing complete compliance with Sections 3-122-33(e) and 3-122-57(a), HAR, shall be placed in the contract project file.

### III. DEPARTMENT'S RESPONSE

LINDA LINGLE  
GOVERNOR

JAMES R. AIONA, JR.,  
LT. GOVERNOR



KURT KAWAFUCHI  
DIRECTOR OF TAXATION

MARIE C. LADERTA  
DEPUTY DIRECTOR

STATE OF HAWAII  
DEPARTMENT OF TAXATION  
P.O. BOX 259  
HONOLULU, HAWAII 96809

July 11, 2005

TO: The Honorable Russ K. Saito, State Comptroller  
Department of Accounting and General Services

FROM: *for* Kurt Kawafuchi, Director

*The Director*

SUBJECT: INTERNAL AUDIT REPORT NO. 05-28, AUDIT OF EXPENDITURES  
FOR THE QUARTER ENDED SEPTEMBER 30, 2004

Pursuant to your request, we have reviewed the audit findings from the draft *Audit of Expenditures for the Quarter Ended September 30, 2004* prepared by the Department of Accounting and General Services, Audit Division. The Department of Taxation concurs with the audit findings and recommendations. The internal audit has provided useful information to improve procurement procedures. The Department is taking actions to ensure proper documentation of small purchases and award notices for competitive bids are posted.

Should you have any questions in this regard, please have your staff contact Mary Ann Teshima, Administrative Services Officer, at 587-1500.